

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

UNITED STATES OF AMERICA,

Plaintiff,

-vs-

D-1: ENIO A. (TONY) MONTINI, JR. and
D-2: JOSEPH A. HOFMEISTER,

Defendants.

CRIMINAL NO.

HONORABLE

VIO: 18 U.S.C. §371
18 U.S.C. §1001
15 U.S.C. §§78j(b) & 78ff

INDICTMENT

THE GRAND JURY CHARGES:

INTRODUCTION

During the times relevant to this indictment,

1. Kmart Corporation (“Kmart”) was a Michigan corporation headquartered in Troy, Michigan. Kmart’s common stock was registered with the United States Securities and Exchange Commission (“SEC”) pursuant to Section 12(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and traded on the New York Stock Exchange until December 19, 2002, when it was delisted.

2. Kmart operated more than 2100 discount stores throughout the United States and employed roughly 250,000 workers. Kmart’s total net sales were approximately \$37 billion, and it was the nation’s second largest discount retailer and the third largest general merchandise

retailer.

3. Kmart's fiscal year ended on the last Wednesday in January. Under the Exchange Act, Kmart was required to file with the SEC quarterly financial statements (Form 10-Q) and a year-end financial statement (Form 10-K) which accurately reported its finances in conformity with the rules and regulations of the SEC.

4. Defendant **ENIO A. (TONY) MONTINI, JR.** ("**MONTINI**") was a Senior Vice President and General Merchandise Manager of Kmart's Drug Store Division. Drug Store was one of five merchandising divisions within Kmart and included such products as cosmetics, batteries, stationery, and greeting cards. Defendant **JOSEPH A. HOFMEISTER** ("**HOFMEISTER**") was a Divisional Vice President of Merchandising within the Drug Store Division (Celebrations and Stationery). **MONTINI**, **HOFMEISTER**, and the other "merchants" at Kmart were responsible for the purchase and marketing of the products handled by their respective divisions, and their performance was measured, in part, by their division's contribution to Kmart's gross margin.

5. Kmart's greeting card business had been divided between American Greetings Corporation (60%) and Hallmark Cards, Inc. (40%). In the latter half of 2000, **MONTINI** and **HOFMEISTER** began negotiating with the two vendors for one of them to become Kmart's sole-source supplier of greeting cards. On or about February 14, 2001, **MONTINI**, on behalf of Kmart, signed a letter of intent to amend and extend Kmart's 1997 agreement with American Greetings to make American Greetings its exclusive source of greeting cards for five years commencing June 1, 2001. The parties agreed that American Greetings would pay Kmart an

“allowance” of \$50,000 per store for the takeover of each “competitive” (i.e. Hallmark-stocked) and newly constructed and acquired store.

6. On or about June 4, 2001, American Greetings took over the “Hallmark” stores, and Kmart, as required by its contract with Hallmark, issued a \$27,298,210 check to Hallmark to repay certain prepaid allowances and other costs. On or about June 20, 2001, American Greetings paid a \$42,350,000 allowance to Kmart as a result of American Greetings’ takeover of the competitive stores.

7. The final written agreement amending Kmart’s 1997 contract with American Greetings was signed on or about January 21, 2002 (the day before Kmart filed bankruptcy). The agreement provided that the \$42,350,000 allowance, as well as certain other costs and expenses incurred by American Greetings, were subject to ratable repayment under certain circumstances, such as Kmart prematurely terminating its agreement with American Greetings.

8. Kmart’s accounting policies required that the \$42,350,000 paid by American Greetings be recognized over the term of the Kmart-American Greetings agreement.

9. **MONTINI** and **HOFMEISTER** were aware from the outset of negotiations with American Greetings that the \$42,350,000 allowance was intended to and would be subject to some type of payback provision, and that American Greetings would capitalize and amortize the expense over the life of its agreement with Kmart. Nevertheless, **MONTINI** and **HOFMEISTER** falsely and fraudulently represented to Kmart’s finance and accounting personnel that there were “no strings attached” to the \$42,350,000, and falsely and fraudulently concealed the fact that the payment would be subject to repayment.

10. As a result of **MONTINI** and **HOFMEISTER**'s actions and omissions, Kmart, instead of spreading the \$42,350,000 payment over the life of its agreement with American Greetings, improperly recognized the entire \$42,350,000 during its 2d quarter ending August 1, 2001-- \$27,298,210 as an offset to the payment to Hallmark and the balance of approximately \$15 million as an "incremental" vendor allowance.

11. On or about August 23, 2001, Kmart filed with the SEC its Form 10-Q for the 2d quarter and issued a related press release. As a result of the improper recognition of the \$42,350,000 allowance paid by American Greetings, Kmart's earnings for the 2d quarter met analysts' expectations but were in fact overstated by \$0.06 per share.

12. On or about May 15, 2002, Kmart announced that it would restate its earnings for the 2d quarter of 2001 to (among other things) exclude the improperly recognized \$42,350,000.

COUNT ONE

D-1: ENIO A. (TONY) MONTINI, JR.

D-2: JOSEPH A. HOFMEISTER

(18 USC §371- Conspiracy)

1. That the introduction to this Indictment is incorporated herein by reference.

2. That from approximately November, 2000, to on or about January 21, 2002,

MONTINI and **HOFMEISTER** willfully and unlawfully combined, conspired, and agreed together to:

a. to knowingly and willfully make and cause to be made false, fictitious and fraudulent material statements and representations, and to knowingly and willfully conceal and cover up material facts by scheme and device, in a matter within the jurisdiction of the SEC, in violation of 18 USC §1001;

b. to knowingly and willfully cause to be made statements which were false and misleading with respect to material facts in a report or document required to be filed under the Exchange Act, in violation of 15 USC §78ff(a);

c. by the use of means and instrumentalities of interstate commerce, the mails, and of the facility of a national securities exchange, to employ a device, scheme, and artifice to defraud; to make untrue statements of material facts; to omit to state material facts necessary in order to make statements not misleading in light of the circumstances under which they were made; and to engage in acts, practices and courses of business that operated as a fraud and deceit upon persons in connection with the purchase and sale of Kmart securities, in violation of 15 USC §§78j(b) and 78ff(b), and 17 CFR §240.10b-5;

d. to knowingly and willfully circumvent the system of internal accounting controls of Kmart, in violation of 15 USC §§78m(b)(2)(B)(ii), and 78m(b)(5).

e. to aid and abet each other in the commission of the aforesaid offenses in violation of Title 18, United States Code, Section 2.

3. The ways, means, and objects of the conspiracy are essentially described as set forth in the introduction to this indictment.

4. In furtherance of the conspiracy and to accomplish the objects thereof, **MONTINI** and **HOFMEISTER** performed and caused to be performed in the Eastern District of Michigan, Southern Division, and elsewhere, the following overt acts, among others:

a. On or about June 21, 2001, **MONTINI** told the Divisional Vice President of Finance for the Drug Store division (“DVP-Finance”) that there were “no strings attached” to the

\$42,350,000 allowance paid by American Greetings.

b. On or about July 17, 2001, the DVP-Finance saw a draft of the proposed agreement between Kmart and American Greetings which indicated that the \$42,350,000 allowance *was* subject to repayment. The DVP-Finance questioned **MONTINI** about the discrepancy, and **MONTINI** and **HOFMEISTER** engaged in a charade wherein **MONTINI** called **HOFMEISTER** into his office and chastised him for preparing the draft incorrectly. **MONTINI** indicated that he would have American Greetings sign a letter reflecting the “correct” understanding regarding the \$42,350,000 payment and asked the DVP-Finance to draft the letter.

c. On or about July 18, 2001, a letter which had been prepared by the DVP-Finance to memorialize that the \$42,350,000 was “a conversion allowance for exclusive merchandising privileges for American Greetings product” was faxed to American Greetings, signed by an American Greetings representative, and faxed back to **HOFMEISTER**.

d. At the close of the 2d quarter, Kmart’s internal auditing staff did not think that the July 18, 2001 letter referenced in the above-paragraph was sufficiently clear that the \$42,350,000 was not subject to repayment. As a result, on or about August 1, 2001, internal audit and the DVP-Finance modified the July 18th letter by adding a second paragraph which specifically stated that “[t]his [\$42,350,000] allowance relates only to the cost of entry and does not imply future obligations for volumes or for length of time associated with the exclusive merchandising privileges. Repayment of this amount is not

required under any circumstances.” On or about August 2, 2001, The DVP-Finance gave the letter to **MONTINI** to forward to American Greetings, and **MONTINI** again called **HOFMEISTER** into his office and reprimanded him in front of the Finance-DVP for having messed up the language in the draft agreement. The Grand Jury does not believe that this letter was ever forwarded to American Greetings.

e. On or about August 2, 2001, **MONTINI** and **HOFMEISTER** provided the DVP-Finance with a faxed letter prepared by American Greetings which indicated that the \$42,350,000 allowance was excluded from the repayment provisions (“exhibit G”) of the original 1997 agreement between Kmart and American Greetings.

f. On or about August 2 or 3, 2001, **MONTINI** and **HOFMEISTER** received, but concealed and did not provide to the DVP-Finance or internal audit, a faxed “side letter” prepared by American Greetings which provided that Kmart would have to pay American Greetings “liquidated damages” per a prorated schedule if Kmart terminated its agreement with American Greetings without cause during the next five years. The “liquidated damages” amount specified was \$42,350,000.

g. On or about August 6, 2001, **MONTINI** signed the two letters described in overt acts “e” and “f” above, and the letters were faxed to American Greetings. These letters were then signed on behalf of American Greetings and faxed back to **HOFMEISTER** at Kmart.

h. On or about August 30, 2001, the DVP-Finance learned of the “liquidated damages” letter and confronted **MONTINI**, who falsely denied having told her that the \$42,350,000 allowance had “no strings attached.”

IN VIOLATION OF TITLE 18, UNITED STATES CODE, SECTION 371.

COUNT TWO

D-1: ENIO A. (TONY) MONTINI, JR.

D-2: JOSEPH A. HOFMEISTER

(18 USC §1001- FALSE STATEMENTS)

1. That the introduction to this Indictment is incorporated herein by reference.
2. On or about August 23, 2001, in the Eastern District of Michigan, Southern Division, **MONTINI** and **HOFMEISTER**, in a matter within the jurisdiction of the SEC, an agency of the Executive Branch of the government of the United States, knowingly and willfully caused a false material statement and representation to be made, and knowingly and willfully concealed and covered up by scheme and device a material fact. That is, the defendants caused Kmart to file with the SEC a Form 10-Q which: overstated Kmart's operating results by \$42,350,000; falsely stated that the 10-Q was prepared in accordance with the rules and regulations of the SEC; falsely stated that the 10-Q reflected all adjustments necessary for a fair statement of the results for the 2d quarter; and concealed the fact that \$42,350,000 of the operating results reported was under certain circumstances subject to repayment.

IN VIOLATION OF TITLE 18, UNITED STATES CODE, SECTION 1001.

COUNT THREE

D-1: ENIO A. (TONY) MONTINI, JR.

D-2: JOSEPH A. HOFMEISTER

(15 USC §§78j(b), 78ff; 17 CFR §240.10b-5- SECURITIES FRAUD)

1. That the introduction to this Indictment is incorporated herein by reference.
2. That from approximately November, 2000, to on or about September 1, 2001, in the Eastern District of Michigan, Southern Division, **MONTINI** and **HOFMEISTER** unlawfully, willfully, and knowingly, directly and indirectly, by use of the means and

instrumentalities of interstate commerce, of the mails, and of the facility of a national securities exchange, used and employed manipulative and deceptive devices and contrivances in connection with the purchase and sale of a security, in contravention of Rule 10b-5 (17 CFR §240.10b-5) of the rules and regulations promulgated by the SEC. That is, the defendants:

- (a) employed devices, schemes, and artifices to defraud;
- (b) made and caused to be made untrue statements of material facts;
- (c) omitted to state material facts necessary in order to make statements not misleading in light of the circumstances under which they were made; and,
- (d) engaged in acts, practices, and courses of business which operated as a fraud and deceit upon investors who purchased and sold shares of Kmart stock.

IN VIOLATION OF TITLE 15, UNITED STATES CODE, SECTIONS 78(j)(b) and 78ff, AND TITLE 17, CODE OF FEDERAL REGULATIONS, SECTION 240.10b-5.

THIS IS A TRUE BILL.

FOREPERSON

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STEPHEN T. ROBINSON (P28030)
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